Supreme Court of the United States

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SUPREME COURT, U. S.

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October Term, 1973

No. 73-1672

UNITED STATES OF AMERICA,

*Petitioner,*

*v.*

BANKERS TRUST COMPANY, GIRARD TRUST BANK, IRVING TRUST COMPANY, MANUFACTURERS HANOVER TRUST COMPANY, THE FIDELITY BANK, AMERICAN NATIONAL BANK AND TRUST COMPANY OF CHICAGO, MANUFACTURERS NATIONAL BANK OF DETROIT, NATIONAL COMMERCIAL BANK AND TRUST COMPANY, PEOPLES TRUST OF NEW JERSEY, THE BANK OF NEW JERSEY, THE BANK OF NEW YORK, THE CITY NATIONAL BANK OF CONNECTICUT and WILMINGTON TRUST COMPANY, as Indenture Trustees; and GEORGE P. BAKER, ROBERT W. BLANCHETTE and RICHARD C. BOND, as Trustees of Penn Central Transportation Company, Debtor,

*Respondents.*

**On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit**

# JOINT BRIEF OF RESPONDENT INDENTURE TRUSTEES IN OPPOSITION

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Dated: July 8, 1974

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*Respondents.*

**On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit**

## JOINT BRIEF OF RESPONDENT INDENTURE TRUSTEES IN OPPOSITION

Respondents Bankers Trust Company, Girard Trust Bank, Irving Trust Company, Manufacturers Hanover Trust Company, The Fidelity Bank, American National Bank and Trust Company of Chicago,* Manufacturers National Bank of Detroit,* National Commercial Bank and Trust Company,* Peoples Trust of New Jersey,* The Bank of New Jersey,* The Bank of New York,* The City National Bank of Connecticut* and Wilmington Trust Company,* as

* Prior to the filing of the Petition, American National Bank and Trust Company of Chicago, Manufacturers National Bank of Detroit, National Commercial Bank and Trust Company, Peoples Trust of New Jersey, The Bank of New Jersey, The Bank of New York, The City National Bank of Connecticut and Wilmington Trust Company succeeded to the indenture trusteeships formerly held by Morgan Guaranty Trust Company of New York.

Indenture Trustees (the "Indenture Trustees"), respectfully submit this Joint Brief in Opposition to the Petition for a Writ of Certiorari to review the judgment of the United States Court of Appeals for the Third Circuit in this matter. The opinion of the Court of Appeals is reported at 494 F. 2d 270 and is set forth as Appendix A to the Petition (App. 1a-37a).[1]

## Question Presented

The sole question raised by the Petition is whether the Emergency Rail Services Act of 1970, 45 U.S.C. 661 *et seq.*,[2] exempts the United States, as the holder of a first lien on all the property of Penn Central Transportation Company, from the time-honored principles of equity governing the duties which a senior lienholder owes junior lienholders.

## Statement

Between November 1972 and February 1973, the Trustees of Penn Central Transportation Company (the "Debtor") sought approval from the Reorganization Court of the sale of four capital assets and the use of the proceeds either to meet the general operating expenses of the railroad or otherwise to invest in the railroad. None of the four properties was subject to liens held by the Indenture Trustees, but each was subject to the lien of the United States arising from its guarantee, pursuant to the Emergency Rail Services Act of 1970, 45 U.S.C. 661, *et seq.*, of

1. References to (App. ) are to the page numbers of the several appendices to the Petition herein.

2. Relevant provisions of this statute are quoted at pages 2-3 of the Petition.

an issue of $100 million in trustees' certificates. The United States' lien covers all the Debtor's property and is superior in priority to the liens of the Indenture Trustees.

In what has come to be known as the *Jersey Central* doctrine, after the decision in *Central R.R. Co. of New Jersey* v. *Manufacturers Hanover Trust Company*, 421 F. 2d 604 (3d Cir.), *cert. denied sub nom., Farrell* v. *Manufacturers Hanover Trust Company*, 398 U.S. 949 (1970), the Courts of Appeals for the Second and Third Circuits have over the years developed standards governing the circumstances under which capital assets of a debtor in reorganization could be sold and the proceeds used to meet its general expenses or otherwise invested without violating the constitutional rights of creditors secured by liens on those assets.[3]

In seeking the approval of the Reorganization Court of their proposed use of the proceeds from the sales of the four capital assets, the Debtor's Trustees did not allege, nor could they have proven, facts sufficient to meet the *Jersey Central* standards. Consequently a creditor, secured by a lien on those properties, had a constitutional right to prevent the sale proceeds from being used to cover the deficit operations of the railroad or otherwise invested in the railroad.

The Indenture Trustees objected to each of the four proposals. Invoking the equitable doctrine of marshaling, they urged that if the United States, with its lien on those properties, was unwilling to exercise its *Jersey Central*

3. The *Jersey Central* doctrine is discussed in detail in the Third Circuit's opinion. 494 F. 2d 275-276, App. 11a-14a.

rights to protect the security for its guarantee of the trustees' certificates, then the Reorganization Court should reduce the United States' lien in an amount equal to the value of the property lost thereby.

The Indenture Trustees' position was rejected by the Reorganization Court, but adopted by the Court of Appeals which reversed and remanded these matters to the Reorganization Court to determine whether the United States had or had not in fact consented to the Debtor's Trustees' proposed use of the proceeds.

## Reasons for Denying the Writ

### *Jersey Central* is sound and was correctly applied by the Court of Appeals.

Significantly the United States does not challenge the soundness of *Jersey Central, supra.* Decided in 1970, that case summarizes earlier decisions relating to the constitutional rights which secured creditors have to protect property subject to their liens from loss through unwise investment in a failing enterprise or in meeting the expenses of its deficit operations. Since 1970, the doctrine embodied in *Jersey Central* has been uniformly and consistently applied to a wide variety of situations.[4]

4. See, *e.g.*, the following decisions of the United States Court of Appeals for the Third Circuit, which as the appellate court with jurisdiction over the reorganizations of the Lehigh Valley Railroad, Penn Central Transportation Company and Reading Company has had to develop a familiarity with and expertise in Section 77 proceedings. *In re Penn Central Transportation Co.* (*Mortgage Releases*), 468 F. 2d 1222 (1972); *In re Penn Central Transportation Co.* (*Selkirk Yard*), 474 F. 2d 832 (1973); *In re Penn Central Transportation Co.* (*Park Avenue Properties*), 484 F. 2d 323, *cert. denied sub nom., Signer* v. *Trustees of Penn Central Transportation Co.*, 414 U.S. 1079 (1973).

Instead the United States urges rather vaguely that the Court of Appeals' decision below "extended" the *Jersey Central* principles and as such "limits the flexibility available to a reorganization court" and "effectively alters the structure of Section 77."[5] Even a cursory reading of the Court of Appeals' opinion below indicates that such is not the case. It is difficult to imagine how else the Court of Appeals could have decided this case without completely overruling the principles embodied in its earlier *Jersey Central* decision.

The difficulty which the United States has with the Court of Appeals' decision stems not from any consideration which, under this Court's Rule 19(1)(b) might justify grant of the writ, but from the fact that the decision prevents the United States from continuing its essentially schizophrenic role in the Debtor's reorganization proceedings. There the United States has part of the time been performing a governmental role in attempting to insure that the transportation services provided by the Debtor are maintained for the benefit of the public, and has at other times been performing as a creditor in attempting to insure that its guarantee of $100 million in trustees' certificates is at all times covered by adequate security. With respect to its willingness to allow the proceeds from the sale of these four capital assets to be used to continue the operations of the Debtor, the United States had clearly suppressed its creditor interests to further its other interests.

It is, however, precisely this sort of creditor schizophrenia that led to the development of the doctrine of marshaling. A court of equity will not allow a senior lienholder, who for reasons of his own fails to exercise his rights to security, to jeopardize thereby the rights of junior lienholders to that security.

5. Petition, pp. 10, 12, 14.

**The Emergency Rail Services Act does not preclude application of marshaling to the United States.**

The United States also argues that the Court of Appeals' decision "has in effect invalidated" and "effectively frustrates" Section 3(b)(3) of the Emergency Rail Services Act of 1970, 45 U.S.C. 662(b)(3). In rejecting that argument below the Court of Appeals held (494 F. 2d at 283, App. 28a):

> "The Emergency Rail Services Act does not expressly forbid application of that [the marshaling] rule to the government's lien. That Act provides that 'proceeds from the sale of assets will be devoted *to the fullest extent possible* to the provision of essential transportation services by the railroad.' 45 U.S.C. §662(b)(3) (emphasis added). A reasonable construction of the statute is that 'to the fuliest extent possible' means to the extent permitted by the fifth amendment in striking the balance, under §77, between secured creditors and the public." (Footnote omitted.)

The holding of the Court of Appeals is, we submit, correct.

In addition the United States argues that that holding is "in direct contravention" of Section 3(c) of the Act on the theory that that section creates an absolute lien. However, in granting the "highest" priority to the lien of the United States, Section 3(c) nowhere suggests that that priority will be maintained regardless of the subsequent behavior of the United States. Here the United States failed to comply with the ordinary rules governing the duties of senior lienholders. Congress could hardly have intended to condone on the part of the government this conduct which courts of equity have for centuries condemned.

## Conclusion

**For the reasons given the Petition for a Writ of Certiorari should be denied.**

Respectfully submitted,

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